

## **— HEARING PANEL REPORT —**

JULY 6, 2006 PUBLIC HEARING

### **ADDRESSING MILK MOVEMENT ISSUES CONTAINED IN THE MILK POOLING PLAN FOR MARKET MILK AND THE STABILIZATION AND MARKETING PLANS FOR MARKET MILK FOR NORTHERN AND SOUTHERN CALIFORNIA**

This report of the Hearing Panel (Panel) regarding proposed amendments to the Milk Pooling Plan for Market Milk (Pool Plan) and to the Stabilization and Marketing Plans for Market Milk for Northern California and Southern California (Stab Plans) is based on the July 6, 2006, hearing record. The record includes the Departmental exhibits, written statements and comments received from interested parties, written and oral testimony received, and written post hearing briefs.

The hearing was called in response to a petition and to claims that the decision rendered at the January 31, 2006 hearing resulted in unnecessary milk movement to the Southern California Class 1 market at the expense of the overall Pool and may have resulted in uncompetitive pricing conditions for the California dairy industry.

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## INTRODUCTION AND WITNESSES

The Department of Food and Agriculture (Department) held a public hearing on Thursday, July 6, 2006, in Sacramento. The hearing considered amendments to milk movement incentives, namely, transportation allowances and transportation credits, as provided in the Milk Stabilization and Marketing Plans for Market Milk (Stab Plans) and the Pooling Plan for Market Milk (Pool Plan). The Department called the hearing after receiving a petition from California Dairies, Inc (CDI). After the notice was issued, alternative proposals were received from Driftwood Dairy (Driftwood), Western United Dairymen (WUD), Security Milk Producers Association (Security), and Dairy Farmers of America (DFA) prior to the deadline for submission of alternative proposals.

### Hearing Witnesses:

A total of ten witnesses/organizations testified including the Department's witness.

1. Steven Donaldson — Department witness
2. \*Gary Korsmeier— CDI
3. Hank Perkins — Security
4. Tiffany LaMendola — WUD
5. Gary Stueve — DFA
6. \*William Schiek — Dairy Institute of California (Institute)
7. James Dolan — Driftwood
8. William Van Dam – Milk Producers Council (MPC)
9. James Gruebele, Land O'Lakes (LOL)
10. Sharon Hale — Crystal Cream and Butter (Crystal)
11. \*Steve James – Swiss Dairy (Swiss)

An “\*” indicates witness/organization who submitted a post hearing brief.

## **GENERAL BACKGROUND FOR MILK MOVEMENT INCENTIVES**

### **Background: Milk Pooling**

In every federal milk marketing order, revenues from farm milk sales are pooled to establish a uniform blend price for all producers who pool their milk within the order. The blend price is modified for each individual producer by location differentials.

Similarly, most revenues from California farm milk sales to California processors are combined into a central Pool. Unlike federal orders, California has two Pool blend prices rather than a single Pool blend price. Under the Pool Plan, the producers' payments result from their allocated quota, base, and overbase at prices that reflect the pool-wide usage of all classes. The monthly quota and base amounts are computed for each producer to the extent these amounts are produced. The current quota allocation determines the maximum monthly quota amount, and the difference between production base and quota determines the maximum monthly base. Any production that exceeds these two figures constitutes overbase production.

Revenue from processors is distributed to dairy farmers via quota, base, and overbase prices. From the inception of statewide milk pooling in 1969 until 1993, Class 1, 2 and 3 farm prices were the primary determinates of the quota price, and Class 4a and 4b farm prices the primary determinates of the overbase price. This was changed by statute enacted in 1993 and made permanent in 1994. Beginning in January 1994, a fixed differential was established so that the quota price is always \$1.70 per hundredweight (cwt.) greater than the base and overbase prices. Historically from 1969 through 1993, the difference between the announced quota and overbase farm prices ranged from \$1.06 to \$2.26 per cwt. on an annual average basis. Currently, revenue above that needed to maintain the \$1.70 differential is shared equally among quota, base and overbase production. The announced quota price is adjusted based on farm location by regional quota adjusters (RQAs). Prices paid to an individual producer depend upon their farm location and their blend of quota, base and overbase holdings.

Not all revenue from milk sales is pooled. Grade B milk is not pooled, nor is it regulated by minimum prices. In California, plants not making any Class 1 or 2 products (manufacturing plants) can opt out of the Pool (although they are still subject to minimum pricing). They generally will not depool, however, if they are receiving any milk from producers owning quota. Over 65 percent of producers own some quota; over 35 percent of producers have at least one third of their milk production covered by quota. Exempt producer-handlers (a.k.a. producer-distributors) do not account to the Pool for all of their Class 1 production. Option exempt producer-handlers do not account to the Pool for their Class 1 production that is covered by the exempt quota they own.

### **Background: Milk Movement**

Producer price regulation established in the mid-1930s brought stability to the dairy industry, but did not guarantee all producers the same price. The price they received depended on the utilization of the plant they shipped to under a plant pooling and contract system. Thus, producers shipping to a plant with high Class 1 usage received more revenue than producers shipping to a plant with high Class 4 usage. There was competition

for Class 1 contracts among producers. In addition, there was an imbalance of market power between a large number of small and disorganized producers and a small number of large fluid processors. These factors tended to lead to market instability and price inequity.

Passage of the Gonsalves Milk Pooling Act in 1967, with its implementation in 1969, corrected many of these problems. However, it removed the incentive that existed under the old contract system for producers to ship their milk to a Class 1 plant. Instead, producers had an incentive to ship to a local plant, which, for most producers is a manufacturing plant. The incentive to ship to a Class 1 plant still exists for exempt producer-distributors, option exempt producer-distributors, and out-of-state milk.

There are various options to address the problem of getting sufficient milk supplies to Class 1 plants. These options are discussed in detail in the August 1999 paper the Department published entitled "*Options to Facilitate Orderly Movement of Milk to California's Fluid Markets*" (January 2006 revised version) (Hearing Exhibit #6e). During 2000 using this paper as a starting point, the Department held a series of four industry workshops that attempted to review fully all aspects of milk movement incentives. A primary objective of the workshops was to try to reach a consensus on potential changes to the structure and scope of the program for milk movement incentives. The workshops concluded without industry consensus; rather, the participants urged the Department to consider reviewing the unresolved issues at two public hearings: June 28 and July 2, 2001. Subsequent hearings were held June 4, 2003, August 4, 2004, and January 31, 2006. These hearings resulted in modifications to the existing milk movement system and not its replacement with a new system (Hearing Exhibit #43).

*Transportation Allowances: What they are and how they work* — When the Pool Plan was instituted in 1969, location differentials were established to provide producers with economic signals to move milk to designated counties. Location differentials were added to or deducted from quota payments to producers and were determined by the location of the plant that first received the milk. When milk was moved to designated counties, favorable location differentials offset the added cost of transporting milk.

As California milk production began to increase, overbase milk became an increasingly larger share of the total milk production. As a result, location differentials based solely on quota milk were no longer an efficient means of ensuring that Class 1 plants received adequate milk supplies. Consequently, a system of "transportation allowances" and RQAs replaced location differentials as a means of ensuring service to the Class 1 plants.

Transportation allowances partially incentivize those producers who are supplying milk to higher valued usage. These allowances apply to all market (Grade A) milk moving from dairy farms to plants in qualifying areas that process more than 50 percent of the milk received into Class 1, Class 2, and/or Class 3 products. In addition, cooperative organizations receive transportation allowances on shipments to their plants if the plant is located in a deficit area and if the plant supplies 40 percent of its receipts for Class 1 usage.

*Transportation Credits: What they are and how they work* — In 1981, transportation credits were introduced to reduce the cost of plant-to-plant shipments. At one time, milk marketing areas in California were more numerous, and differences in cwt. prices among the milk marketing areas were sufficient to cover the cost of moving milk from one processing plant

to another. However, with marketing area consolidation, these price differences were no longer capable of covering the cost of interplant shipments.

Transportation credits offset some of the cost of hauling milk assigned to Class 1 usage from plants in designated supply counties to plants in designated deficit counties. Handlers located in designated supply counties may deduct a specified transportation credit from applicable minimum prices for bulk market milk, bulk market skim milk and condensed skim milk shipped to a plant located in a designated deficit county. Shipments of market cream are not currently covered by transportation credits.

*Call Provisions: What they are and how they work* — Milk movement requirements, commonly referred to as “call provisions”, were instituted in 1979. They function by bestowing a ranking system for quota milk use when milk supplies are insufficient to meet the demand for fluid milk. Basically, call provisions require that manufacturing plants participating in the Pool (i.e., plants receiving milk entitled to the quota price) must make a portion of the milk received available to plants processing Class 1 dairy products upon request. Call provisions allow fluid plants to request milk from manufacturing plants, mitigating the impact of producer shipment decisions. In other words, it does not matter to which plant producers ship milk; call provisions give qualifying Class 1 plants the ability to obtain milk from manufacturing plants when it is needed.

*Regional Quota Adjusters: What they are and how they work* — While RQAs do not provide any direct incentive to move milk to Class 1 plants, they relate to a basic principle of location economics. Most Class 1 plants are located in or near the major population centers for economic reasons. Under normal conditions, Class 1 plants attract the nearest milk supply over more distant rural milk production areas. As a consequence, milk produced in close proximity to processing plants has more value.

RQAs, which with transportation allowances replaced location differentials, follow this economic principle. Geographical location of the producer’s dairy determines the RQA that is deducted from the quota payments to the producer. RQAs apply to the cwt. equivalent of quota milk produced. Presently, these rates range from \$.05/cwt. for dairy farms located in North Coast counties to \$.27/cwt. for dairy farms located in Fresno, Kings, and Tulare counties. There are no RQAs assigned to dairy farms located in the southernmost part of the state.

More complete discussions of transportation allowances, transportation credits, RQAs and call provisions can be found in the Departmental publication, “*Options to Facilitate Orderly Movement of Milk to California’s Fluid Markets*” (Hearing Exhibit #6e).

## SUMMARY OF PROPOSALS AND IMPACTS

**Transportation Allowances.** The proposed changes to transportation allowance rates and mileage brackets are summarized in Table 1.

*Table 1 - PROPOSED CHANGES TO TRANSPORTATION ALLOWANCES: Ranch-to-Plant  
Crystal, Driftwood and Western United Dairymen proposals would not affect transportation allowances  
(In Dollars Per Hundredweight)*

	CONSTRUCTIVE MILES	Current since April 2006	CDI Proposal	Security Proposal	DFA Proposal
<b>Bay Area Receiving Area</b>	0 to 99	\$0.26	\$0.27		\$0.27
	99 to 199	\$0.31	\$0.32		\$0.34
	199 +	\$0.32	\$0.33		\$0.36
<b>North Bay Receiving Area</b>	0 to 44	\$0.19			\$0.20
	44 to 99	\$0.26			\$0.29
	99 +	\$0.31			\$0.35
<b>Sacramento Receiving Area</b>	0 to 59	\$0.14			\$0.15
	59 +	\$0.17			\$0.19
<b>San Diego Receiving Area</b>	0 to 89	\$0.10	\$0.11		
	89 to 139	\$0.43	\$0.38		
	139 +	\$0.65	\$0.38		
<b>Southern California Receiving Area *</b>	0 to 89	\$0.10	\$0.11	\$0.11	\$0.11
	89 to 109	\$0.20	\$0.38	\$0.38	\$0.36
	109 to 139	\$0.52	\$0.55	\$0.57	\$0.55
	139 +	\$0.65	\$0.74	\$0.80	\$0.72

Additionally, CDI proposed elimination of the last two brackets for "Barstow milk", and to change the mileage break between the 2nd and 3rd brackets from 122 to 109 miles.

The analysis of the transportation allowance proposals used monthly averages of historical milk movement for the twelve months ending April 2006. The Department generated the data in Table 2 using different filters as proposed in the petition and alternate proposals in Table 1, including changes in mileage brackets and changing the allowance rates:

- The petition by CDI to change brackets and rates would have increased costs to the Pool by \$237,138/month.
- The proposal by Security to change brackets and increase rates would have increased costs to the Pool by \$331,670/month.
- The proposal by DFA to change brackets and increase rates would have increased costs to the Pool by \$225,827/month.

**Table 2 - Monthly Increase in Transportation Allowance Costs  
Current System Compared to CDI, Security and DFA Proposals  
Proposed less Current Total of \$1.93 million per month  
May 2005 through April 2006  
(In Million Dollars per month)**

	CDI	Security	DFA
Northern California	\$0.01	\$0.00	\$0.03
Southern California	\$0.23	\$0.33	\$0.20
<b>TOTAL</b>	<b>\$0.24</b>	<b>\$0.33</b>	<b>\$0.23</b>

**Transportation Credits.** The proposed changes to transportation credit rates and county eligibility are summarized in Table 3.

Table 3 - PROPOSED CHANGES TO TRANSPORTATION CREDITS: *Plant-to-Plant*  
Security and DFA proposals would not affect transportation credits.  
(In Dollars Per Hundredweight)

SUPPLY COUNTIES	DEFICIT COUNTIES		CURRENT SINCE APR 2006	CDI	Driftwood	WUD <sup>1/</sup>	Crystal
Los Angeles	Orange, Riverside, San Bernardino, San Diego and Ventura	Differential <sup>2/</sup>	\$0.00	\$0.00			
		Credit	\$0.26	\$0.37			
		<b>Total</b>	<b>\$0.26</b>	<b>\$0.37</b>			
Tulare	Los Angeles, Orange, and Ventura	Differential	\$0.27	\$0.27	\$0.27		
		Credit	\$0.69	\$0.76	\$0.91		
		<b>Total</b>	<b>\$0.96</b>	<b>\$1.03</b>	<b>\$1.18</b>		
	Riverside, and San Diego	Differential	\$0.27	\$0.27			
		Credit	\$0.77	\$0.85			
		<b>Total</b>	<b>\$1.04</b>	<b>\$1.12</b>			
Kings and Fresno	Los Angeles, Orange, and Ventura	Differential	\$0.27				
		Credit	\$0.72				
		<b>Total</b>	<b>\$0.99</b>				
	Riverside, and San Diego	Differential	\$0.27				
		Credit	\$0.80				
		<b>Total</b>	<b>\$1.07</b>				
Merced and Stanislaus (part)	Alameda, San Francisco and Santa Clara	Differential	\$0.00				
		Credit	\$0.38				
		<b>Total</b>	<b>\$0.38</b>				
Merced and Stanislaus (part)	Sacramento	Differential					\$0.00
		Credit					\$0.60
		<b>Total</b>					<b>\$0.60</b>

<sup>1/</sup> WUD does not propose any rate changes, only the elimination of condensed skim as an eligible product.

<sup>2/</sup> Area differentials based on whole milk \$0.27 = \$0.0031 x 87.8;  
for skim the differential would be \$0.28 = \$0.0031 x 90.9; and  
for condensed skim \$0.21 = \$0.0031 x 68.0

The analysis of the transportation credit proposals used monthly averages of historical milk movement for the twelve months ending April 2006. The data in Table 4 was generated using different filters as proposed in the alternative proposals in Table 3. These filters included changing transportation credit rates, eliminating condensed skim as an eligible product, and adding Sacramento County as a deficit county:

- CDI's proposal to increase rates for milk moving into and within Southern California would have cost the Pool an additional \$30,006 /month.
- Driftwood's proposal to increase rates for milk moving into and within Southern California would have cost the Pool an additional \$6,532 /month.
- WUD's proposal to eliminate eligibility for condensed skim would have saved the Pool \$21,416 /month.
- There was not sufficient information to analyze Crystal's proposal.

**Table 4 - Monthly Increase (Decrease) in Transportation Credits Costs  
Current System Compared to CDI, WUD and Crystal Proposals**

	<i>(In Dollars Per Month)</i>			
	CDI	Driftwood	WUD	Crystal*
Whole, 2-10, 1-11	\$19,363	\$97	\$0	
Skim	\$7,640	\$5,008	\$0	
Condensed Skim	\$3,003	\$1,427	-\$21,416	
<b>TOTAL</b>	<b>\$30,006</b>	<b>\$6,532</b>	<b>-\$21,416</b>	<b>N/A</b>

There was not sufficient information to analyze Crystal's proposal.

## GENERAL DISCUSSION

The Panel reiterates the economic and marketing factors listed in the Panel Report for the January 2006 hearing. These factors warrant the continuation of the milk movement system. All are important policy condensations in making recommendations for proposed changes to the transportation allowances and credits (commonly referenced as the milk movement incentive system):

- *“Prior to the establishment of milk pooling, a dairy producer’s income was directly related to the actual processing plant that the producer sent their milk. If the plant had a high Class 1 usage, then the producer’s income reflected the higher Class 1 price. If the receiving plant made Class 4 products, then the producer’s income reflected the Class 4 prices. . .*
- *After the establishment of milk pooling: A dairy farm’s revenues do not increase when the farm ships their milk to the highest usage (Class 1, 2, 3) plants. . . Since manufacturing plants are typically operated in rural locations in closer proximity to dairy farms, dairy farms can normally minimize their hauling costs by shipping to these plants. . . [Thus] the cost of hauling milk from the farm to the processing plant becomes a governing factor for determining the destination of the farm milk shipments. . .*
- *The total cost of the transportation allowance and credit system is borne by the Pool.*
- *All producers that share in Pool revenues benefit from higher revenues of Class 1, 2, and 3. – even if their farm milk sales are not shipped to the higher usage plants.*
- *Many producers are paid premiums outside the Pool revenues by manufacturing plants. The availability of these premiums provide additional economic incentives to farms to ship their milk supply to manufacturing plants instead of fluid plants.*
- *As the dairy farms relocate away from metropolitan markets, the annual cost of the milk transportation allowance and credit system will continue to increase . . . (See Table 5)*

**Table 5 - Average Monthly Cost of  
Milk Movement Incentives**

	<i>(In Million Dollars)</i>		
	1984	1994	2004*
Credits	\$0.09	\$0.18	\$0.24
Allowances	\$0.28	\$0.34	\$1.44
<b>TOTAL</b>	<b>\$0.37</b>	<b>\$0.52</b>	<b>\$1.68</b>

\* In 2004, 78 percent of the total cost was for Southern California.

As stated in the Panel Report for the January 2006 hearing, the Panel’s approach for recommended changes to and analysis of proposed rates for transportation allowances and credits has changed over time:

1. Rates for allowances should be the hauling costs, less any adjustments. From 1983 through 1996 in setting the transportation allowance rates, the Panel primarily considered:
  - a. The cost to haul milk from rural ranches to urban plants (distant haul),
  - b. Less the cost to haul milk within the rural area (local haul), and
  - c. Less a modest shortfall.

2. Rates for credits should be the hauling costs, less any adjustments. From 1983 through 1996 in setting the transportation credit rates, the Panel primarily considered:
  - a. The cost to haul tailored milk from country plants to urban Class 1 plants,
  - b. Less any differential between the rural plants' Class 1 price and the urban plants' Class 1 price, and
  - c. Less a modest shortfall.
3. The rates for allowances and credits should result in comparable costs. Starting with the June-July 2001 hearing, the Panel began to place more consideration on:
  - a. The cost to the Pool of the transportation credits for shipping tailored milk via plant-to-plant shipments, and
  - b. The cost to the Pool for comparable transportation allowances for ranch-to-plant shipments.

The relative costs did not have to be equal, only comparable.

4. When a plant has a combination of allowances and credits, the cost of the combination should be comparable to the cost of the credits only for competing plants. Starting with the January 2006 hearing, the Panel began to place more consideration on:
  - a. The cost to the Pool of the transportation credits for shipping tailored milk via plant-to-plant shipments, and
  - b. The cost to the Pool for comparable transportation allowances for ranch-to-plant shipments plus the cost of the transportation credits for milk moved plant-to-plant within Southern California.

Again, the relative costs do not have to be equal, only comparable.

Based on all the above, the Panel reiterates the general conclusions made in the Panel Report for the January 2006 hearing:

- *“California producers have the responsibility to ensure that the higher valued usages are supplied. The cost of the transportation allowance and credit system is the producers’ obligation to finance this responsibility. In return, all producers that participate in the Pool revenues get the opportunity to share in the blended revenues of the higher priced class usage.*
- *California manufacturing plants that satisfy the California Pool qualification requirements and thereby enable the producers that ship farm milk to their plants to participate in the Pool revenues also have the responsibility to make milk supplies available to the higher value usages when needed.*
- *Costs for diesel fuel have increased significantly over the past few years (Hearing Exhibit #6b). As a result, the cost for hauling milk to fluid plants in metropolitan markets has increased since the last public hearing on this subject matter on [January 31, 2006.*
- There are five reasonable and sound principles for establishing appropriate transportation allowance and credit rates]:
  1. *Reimbursement to producers for the added costs of serving the higher valued usage of the fluid market.*
  2. *The closest milk supply to the market should be the first to be used.*
  3. *The system should attempt to minimize costs to the Pool.*
  4. *When setting allowances and credits, equity among competing Class 1 plants in attracting milk supplies must be considered.*
  5. *Equally important, encouraging or promoting monopoly power on supplying producer organizations - preserving fair competition among competing milk suppliers.”*

## DISCUSSION AND RECOMMENDATIONS FOR

## **TRANSPORTATION ALLOWANCES NORTHERN CALIFORNIA**

### **Background**

Transportation allowances for milk supplied to North Bay, Bay Area, and Sacramento deficit areas presented little controversy among witnesses testifying at this hearing. The majority of witnesses support the notion that transportation allowances should make producers indifferent between shipping milk to a distant Class 1, 2 or 3 processing plant versus a closer manufacturing plant.

Witnesses that proposed changes to specific rates focused their testimony to areas in which they supplied milk. These proposals appeared to be reasonable relative to recent increases in both hauling rates and fuel costs, and were fairly consistent among witnesses.

### **Proposals and Analysis**

At the hearing CDI proposed to increase the rate in the Bay Area receiving area \$0.01/cwt in all mileage brackets, while leaving North Bay and Sacramento unchanged. Had the rates proposed been in place for the 12 months ending April 2006, they would have increased the monthly average cost to the Pool by \$400,678. However changing the rates in one of the Northern California receiving areas, without changing the others may cause issues between handlers competing for the same milk. See discussion below.

DFA presented a proposal to change the rates in all three active Northern California receiving areas as follows.

For the Bay Area Receiving Area:

- + \$0.01/cwt. from \$0.26/cwt. to \$0.27/cwt. for 0 to 99 miles
- + \$0.03/cwt. from \$0.31/cwt. to \$0.34 /cwt. for 99 to 199 miles
- + \$0.04/cwt. from \$0.32/cwt. to \$0.36/cwt. for over 199 miles

The North Bay Receiving Area:

- + \$0.01/cwt. from \$0.19/cwt. to \$0.20/cwt. for 0 to 44 miles
- + \$0.03/cwt. from \$0.26/cwt. to \$0.29/cwt. for 44 to 99 miles
- + \$0.04/cwt. from \$0.31/cwt. to \$0.35/cwt. for over 99 miles

The Sacramento Receiving Area:

- + \$0.01/cwt. from \$0.14/cwt. to \$0.15/cwt. for 0 to 59 miles
- + \$0.02/cwt. from \$0.17/cwt. to \$0.19/cwt. for over 59 miles.

The testimony of both the Institute and Crystal cautioned the Department that changes in transportation allowance rates can have the unintended consequence of disadvantaging plants operating within the same marketing area, potentially causing milk to shift from supplying one deficit area to another. The Department addressed such a situation with the August 2004 milk movement hearing by adding Sonoma and Marin to the North Bay receiving area. When setting the rates for the newly

expanded North Bay area, Sacramento, and the Bay Area receiving areas, the Department was careful not to encourage such shifts.

As outlined in the previous section the cost of diesel fuel is rising and is predicted to continue to do so. Additionally, testimony referring to transportation allowances in Northern California reiterated this fact and stated that the rising haul cost was the main reason for the proposed increased rates. The Panel believes this is sufficient justification for its recommendation.

### **Panel Recommendations:**

For the Bay Area Receiving Area:

1. +\$0.01/cwt. from \$0.26/cwt. to \$0.27/cwt. for 0 to 99
2. +\$0.03/cwt. from \$0.31/cwt. to \$0.34/cwt. for over 99 to 199
3. +\$0.04/cwt. from \$0.32/cwt. to \$0.36/cwt. for over 199

For the North Bay Receiving Area:

1. No change for 0 to 44 mileage bracket, will remain at \$0.19/cwt.
2. +\$0.03/cwt. from \$0.26/cwt. to \$0.29/cwt. for over 44 to 99
3. +\$0.03/cwt. from \$0.31/cwt. to \$0.34/cwt. for over 99

For the Sacramento Receiving Area:

1. +\$0.01/cwt. from \$0.14/cwt. to \$0.15/cwt. for 0 to 59
2. +\$0.03/cwt. from \$0.17/cwt. to \$0.20/cwt. for over 59

Most producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$24,079/month of Pool revenues. To fund all transportation allowances in Northern California, total compensation will increase 6.14 percent to \$415,946/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

## **DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION ALLOWANCES SOUTHERN CALIFORNIA**

### **Mileage Brackets and Eligible Counties**

The transportation allowance issues for Southern California and Northern California are uniquely different. In Northern California, there are only five medium-to-large fluid plants in the three receiving areas: one in Sacramento and two each in North Bay and the Bay Area. Within one receiving area, all plants are less than 40 miles apart. Each area draws its milk from one or two supply areas, making it fairly straightforward to establish mileage brackets and allowance rates.

The Southern California Receiving Area, by contrast, has nine medium-to-large fluid plants all located in one receiving area. The plants cover a larger geographic area and some plants are over 60 miles apart. This one receiving area draws milk from four supply areas:

- San Joaquin Valley via I-5 south,
- High Desert via I-15 south,
- Inland Empire via I-10 west, and
- San Diego via I-5 & I-15 north.

These differences make it difficult to establish uniform mileage brackets and allowance rates for the Southern California Receiving Area. Different trucking firms facing different conditions can be supplying milk from the four supply areas to a variety of different plants in the receiving area.

CDI's proposal identified three issues regarding the current transportation allowance system for the Southern California receiving area:

1. The current allowance rates are too low;
2. The current mileage brackets encourage inefficient milk movement; and
3. The Barstow area milk is over compensated relative to other milk.

To address these issues CDI has proposed to make three changes to the transportation allowances in Southern California:

1. A general increase in most allowance rates;
  2. One change in the mileage brackets; and
  3. A lower limit on the allowance rate for Barstow area milk compared to other milk.
- (see Table 6)

**Table 6 - Current and Proposed Transportation Allowance Rates  
Southern California Receiving Area**

	CURRENT				CDI PROPOSAL			
	Constructive Miles		Rates		Constructive Miles		Rates	
<b>Southern California Receiving Area</b>	0	to	89	\$0.10	0	to	89	\$0.11
<b>From Riverside and</b>	89	to	122	\$0.20	89	+		\$0.38
<b>San Bernardino counties</b>	122	to	139	\$0.52				
	139	+		\$0.65				
<b>From the 56 other counties</b>	0	to	89	\$0.10	0	to	89	\$0.11
<b>in California</b>	89	to	122	\$0.20	89	to	109	\$0.38
	122	to	139	\$0.52	109	to	139	\$0.55
	139	+		\$0.65	139	+		\$0.74
<b>Rates changes</b>								
<b>Other changes</b>								

## Mileage Brackets

Over compensation of Barstow area milk moving into eligible plants was an issue at the previous two milk movement hearings: August 2004 and January 2006. The Department addressed this issue by creating additional mileage brackets to segregate the Barstow area milk from milk coming from San Diego and from San Joaquin Valley. Testimony at the July 2006 hearing, however, suggested that the additional brackets created problems for milk both from San Diego and from San Joaquin Valley. CDI testified that the only practical solution was to establish two sets of rates - one for the Barstow area and one for all other areas:

*“We have approximately 250,000 pounds of milk in San Diego County. That is 110 to 121 miles from the Class 1 markets in the Los Angeles area. Without our recommended changes, this milk will have an incentive to move to a Riverside County cheese plant . . . [requiring] CDI to haul more milk out of Tulare County at a higher transportation allowance . . . The last justification for adopting our mileage bracket recommendation and rates is south Kern County milk moving into the Los Angeles market. . . . The most recent decision to expand one of the mileage brackets to 122 miles places a 35 cent per hundredweight disadvantage for CDI to move south Kern County milk, which in our -- amounts to 650,000 pounds of milk a day that’s in that bracket to the Los Angeles area. This needs to be corrected as soon as possible, or CDI will have to divert this milk to Tulare via backhaul . . . and move Tulare County milk to Los Angeles at a 45-cent per hundredweight additional cost to the producer Pool under the current pooling plan.”*

The Panel finds that the current mileage brackets are creating difficulties for the orderly movement of milk from San Diego and San Joaquin Valley. Adopting CDI’s proposed 109-mile cutoff between the second and third mileage bracket would address these issues.

## Separate Rates for Barstow Area Milk

The 109-mile cutoff does not address CDI's second issue: separate rates for Barstow area milk. To set separate rates, CDI used county boundaries. They proposed one set of rates for Riverside and San Bernardino counties (the Barstow area) and a second, higher set of rates for the 56 other counties in California. The Barstow area, however, also includes the high desert of Los Angeles County. The Panel believes that Los Angeles County should be added to San Bernardino and Riverside counties as part of the Barstow area.

In reviewing CDI's concept, the Panel compared two possible benefits of establishing separate rates: one for the Barstow area (the counties of Los Angeles, Riverside and San Bernardino) and one for the 55 other counties in California:

*Table 7 - Breakdown of Transportation Allowance  
Mileage Bracket Ranges*

		CONSTRUCTIVE MILES	
<b>Southern California Receiving Area</b>			
<b>From Los Angeles, Riverside and San Bernardino counties</b>	0	to	89
	89	+	
<b>From the 55 other counties in California</b>	0	to	89
	89	to	109
	109	to	139
	139	+	

The review showed that CDI's concept was effective in setting balanced compensation for producers in the four supply areas: San Joaquin Valley, High Desert, Inland Empire, and San Diego. The Panel, however, has slight concerns regarding unintended consequences for the eastern parts of Riverside and San Bernardino counties.

### Panel Recommendation:

- Establish separate rates and brackets for milk coming from Los Angeles, Riverside and San Bernardino counties compared to the other 55 counties in California.
- Adopt a 109-mile cutoff between the second and third mileage brackets for the other 55 counties.
- Eliminate the last two mileage brackets for Los Angeles, Riverside and San Bernardino counties.

The actual levels of transportation allowance rates for Southern California are discussed in the next section.

## Rates for Southern California

### Background

The milk supply for the Southern California Receiving Area continues to change. As discussed at the January 2006 hearing, the once major supplier of milk in Southern

California, the Chino Valley, is diminishing due to urbanization. This affects availability of local ranch milk for Southern California processors. Many Chino producers have moved to the San Joaquin Valley (Kern County and northward), others have looked to Imperial County, and still others to outside of California. In most instances, the distances that milk will need to travel to fluid plants will be greater.

Many of the Class 1 plants are located in urban areas of Los Angeles and Orange counties, while manufacturing plants are located in more rural areas closer to dairies. Hauling costs to move milk continued to escalate in the past six months due to continuing high fuel prices caused by low supply, high demand and geopolitical issues. With these dynamics, the need and means to attract milk to fluid plants continues to increase.

## **Proposals and Analysis**

As a result of facing higher transportation costs and increasing distances from producer milk, dairy cooperatives in California have requested adjustments to the transportation allowance rates for producer milk delivered to Southern California plants for Class 1, 2 and 3 purposes (see Table 1). The hearing witnesses concurred that transportation allowance rates need to be adjusted to meet the rising cost of hauling due to fuel price increases. Finally, the witnesses favored the application of the policy considerations and general conclusions listed in the Panel Report for the January 2006 hearing. (See General Discussion of this document).

CDI testimony indicated they are having difficulty in serving the Class 1 market in Southern California and maintaining the least cost for transportation allowances to the Pool. CDI stated several areas of concern:

- Milk moving out of Kern County having a lower cost to be transported to Tulare (via a backhaul) than for Tulare County milk to be shipped to Southern California.
- Over-compensation for transportation costs for producer milk shipped from the Barstow area to the Southern California Receiving Area.
- Under-compensation of producer milk coming from San Diego County into the Southern California Receiving Area.

CDI presented testimony and documentation from Kings County Trucking Lines on the latest hauling charges effective June 15, 2006 as evidence of the additional costs that have been implemented by their trucking firm. Likewise DFA and Security submitted their trucking invoices as further evidence of higher costs related to transportation.

Finally, many of the witnesses including LOL, DFA, and Security supported CDI's proposal to adjust the mileage brackets for the distances encompassing over 89 to 139 miles for milk received in the Southern California Receiving Area.

## **Southern California Receiving Area**

CDI proposed changing mileage brackets and increased rates for all four mileage brackets:

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt. for 0 to 89 miles
2. +\$0.18/cwt. from \$0.20/cwt. to \$0.38/cwt. for over 89 to 109 miles (currently 89 to 122 miles)
3. +\$0.03/cwt. from \$0.52/cwt. to \$0.55/cwt. for over 109 to 139 miles (currently over 122-139 miles)

4. +\$0.09/cwt. from \$0.65/cwt. to \$0.74/cwt. for over 139 miles

DFA and Security had similar proposals, except:

- DFA proposed a \$0.16 increase for over 89 to 109 mileage bracket to \$0.36/cwt.;
- Security proposed a \$0.05 increase over 109 to 139 mileage bracket to \$0.57/cwt.
- Security proposed a \$0.15 increase in the over 139 mileage bracket to \$0.80/cwt.
- DFA proposed a \$0.07 increase in the over 139 mileage bracket to \$0.72/cwt.

The three proposals would have increased the average monthly cost to the Pool by:

- \$228,075 for CDI
- \$200,000 for DFA
- \$331,670 for Security

Adjustments to transportation allowance rates and mileage brackets should be cost justified; a shortfall should be applied to rates for milk received from distant sources, and the closest milk should be encouraged to move first. Evidence from witnesses and information from the U.S. Department of Energy on diesel prices data (see Hearing Exhibit 6b) indicate the need for increases in transportation allowance rates. Increases in hauling rates and fuel surcharges were seen on invoices from trucking firms that were entered into the Hearing record. With the relocation of dairies from the Chino Valley away from urban areas where Southern California fluid plants are located, the need to maintain the incentives to move producer milk to fluid plants remains greater than ever.

The Panel in reviewing transportation costs also considered the amount of increase in diesel fuel costs during the first half of 2006 and the distances involved in moving milk serving the Class 1 market. The results of this analysis were considered with the testimony of witnesses in determining the Panel's proposal to increase transportation allowances.

As mentioned in the prior section on mileage brackets, the adoption of CDI's proposed 109-mile cutoff between the second and third mileage bracket would assist in the orderly movement of milk to the Southern California Receiving Area from San Diego County and the San Joaquin Valley.

#### **Panel Recommendation:**

- Change the over 89 to 122 mileage bracket to over 89 to 109 miles
- Change the over 122 to 139 mileage bracket to over 109 to 139 miles
- Change the following rates for the Southern California Receiving Area, from all counties other than Los Angeles, Riverside and San Bernardino counties:
  1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt. for 0 to 89 miles
  2. +\$0.17/cwt. from \$0.20/cwt. to \$0.37/cwt. for over 89 to 109 miles
  3. +\$0.04/cwt. from \$0.52/cwt. to \$0.56/cwt. for over 109 to 139 miles
  4. +\$0.05/cwt. from \$0.65/cwt. to \$0.70/cwt. for over 139 miles

Producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.17/cwt. This increased compensation will be funded by redistributing an additional \$150,795/month of Pool revenues. To fund this portion of transportation allowances in the Southern California Receiving Area, total compensation will increase 10.88 percent to \$1.54 million/month of Pool revenues. (This estimated

funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **Barstow Area Milk**

The transportation allowance issue of milk moving from the Barstow area to the Southern California receiving area was raised again at this hearing. Testimony from CDI indicated that the changes made at the January 31, 2006 hearing did not adequately address the over-compensation problem on Barstow area milk for their affected members. DFA testified that this change also had unintended consequences for some of their producers. These producers are now receiving the lower compensation when their freight costs remains the same as other DFA producers in the Barstow area. Institute, LOL, WUD, and Security testified in support of CDI's proposal to correct the Barstow area situation.

The transportation allowance rate for local milk was increased to reflect higher transportation costs. The over 89 miles bracket rate was kept at the \$0.20/cwt. rate to address the issue of over-compensation on transportation allowance for milk moving from dairies in the Barstow area to the Southern California Receiving Area.

The Panel proposes two strategies to be implemented to assist in solving the above mentioned issues:

- Establish a separate supply area for milk from Los Angeles, Riverside and San Bernardino counties delivered to the Southern California Receiving Area, with only two mileage brackets (0-89 miles and over 89 miles).
- Adjust allowance rates due to increases in transportation costs, but only for the 0-89 mileage bracket.

### **Panel Recommendation:**

Establish Los Angeles, Riverside and San Bernardino counties as Supply Counties to the Southern California Receiving Area with the following rates:

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt., for 0 to 89 miles
2. No change, remain at \$0.20/cwt., for over 89 miles

Producers serving the fluid market in the 0 to 89 miles bracket will receive increased compensation of \$0.01/cwt. Producers beyond 109 miles will receive decreased compensation of \$0.32/cwt. to \$0.45/cwt. This change in compensation will result in a net reduction in redistribution of Pool revenues of \$19,738/month. To fund this portion of transportation allowances in the Southern California Receiving Area, total compensation will decrease 13.71 percent to \$124,183/month of Pool revenues. (This estimated funding decrease assumes that these rates had been in place during the 12 months ending April 2006).

### **Net Effect of Recommendations for the Southern California Receiving Area**

Most producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.17/cwt., while some producers in the Barstow area will receive decreased compensation of \$0.32/cwt. to \$0.45/cwt. This net increase in compensation will be funded by redistributing an additional \$131,056/month of Pool revenues. To fund all transportation allowances in the Southern California Receiving

Area, total compensation will increase 8.57 percent to \$1.66 million/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **San Diego Receiving Area**

CDI proposed rate changes for all three mileage brackets:

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt. for 0 to 89 miles
2. -\$0.05/cwt. from \$0.43/cwt. to \$0.38/cwt. for over 89 to 139 miles
3. -\$0.27/cwt. from \$0.65/cwt. to \$0.38/cwt. for over 139 miles

The proposal by CDI would have increased the average monthly cost to the Pool by \$250.

CDI submitted the proposal for the San Diego Receiving Area, but supportive evidence was not given to the Panel. CDI testified at the January 31, 2006 transportation hearing that since little milk travels over 89 miles to the San Diego Receiving Area; transportation allowance rates for milk traveling over 89 miles should be limited to \$0.31/cwt.

WUD agreed with CDI's proposal to have only two mileage brackets (0-89 and over 89 miles). WUD stated that since there are sufficient closer sources of milk to serve the one fluid plant in San Diego, there is no reason to provide greater incentives to attract milk farther out. If conditions in the future changes, the rates can be adjusted at that time.

The Panel reiterates its recommendation from the January 31<sup>st</sup> transportation hearing to maintain three mileage brackets. The amount of local producer milk serving the San Diego receiving area continues to decline faster than the rest of Southern California. Problems with producer milk availability have become similar to those of fluid handlers located in the Southern California Receiving Area. As dairies leave the Southern California area, there will be a growing need for milk supplies further away from the San Diego area. The most recent hauling costs survey indicates that the local haul rate is \$0.37/cwt. Milk from San Jacinto to San Diego was surveyed at \$0.43/cwt. While the Panel does not have hauling rate data for ranch milk coming into the San Diego Receiving Area in the over 139 miles mileage bracket, the potential need to serve this market from this distance is evident. In addition, the San Diego Receiving Area is in competition for milk supplies with the Southern California Receiving Area and with continuing increases in fuel costs as evidenced in testimony and economic data, the adoption of \$0.70 cwt. for the over 139 miles mileage bracket has validity.

### **Panel Recommendation:**

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11 for 0 to 89 miles
2. No change in the \$0.43/cwt. rate for over 89 to 139 miles
3. +\$0.05/cwt. from \$0.65/cwt. to \$0.70/cwt. for over 139 miles

Many producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.05/cwt. This increased compensation will be funded by redistributing an additional \$600/month of Pool revenues. To fund transportation allowances in the San Diego Receiving Area, total compensation will increase 8.36 percent to \$7,785/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

## **DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION CREDITS FOR FLUID MILK AND CONDENSED SKIM**

### **Background**

Dairy farms produce milk every day. There are seasonal fluctuations in this supply of milk. The volume tends to be highest during the “spring flush.” While the test of milk tends to average about 3.5 percent fat and 8.7 percent solids-not-fat (SNF), the tests vary, tending to peak in the fall. Regardless of these fluctuations, all the milk needs to be processed every day. Generally, Class 4a processors, the vast majority of whom are cooperative, balance these seasonal fluctuations in volume and test.

Based on market and efficiency considerations, fluid milk processors face fluctuations in production and demand for fluid milk products. Fluid demand falls seasonally with summer vacations and with school holidays. Additionally for efficiency and marketing considerations, some fluid processors do not operate their plants seven days per week. Finally, while milk from the farm generally tests about 3.5 percent fat and 8.7 percent SNF, consumer demand for milk with less fat results in fluid milk products having an average test of about 2.2 percent fat and 9.9 percent SNF. Thus, while fluid processors face seasonal excesses in bulk milk supplies, they always face excess fat supplies.

Fluid processors have a number of solutions to deal with seasonal excess bulk milk and the constant excess fat:

- (1) Make significant investment in building and equipment to process the excess bulk milk and fat into other products.
- (2) Separate the excess milk components and market them to other dairy processors.
- (3) Divert the excess bulk milk to other dairy processors.
- (4) Contact with a cooperative:
  - (a) to supply only the bulk milk needed;
  - (b) to supply the condensed skim needed; and/or
  - (c) to supply tailored milk.
- (5) Use a combination of the above.

Regardless of how they balance their excess fat and bulk milk, fluid processors must bear the associated costs as a normal business expense. The costs of self-balancing, charges for cooperative balancing, and charges for cooperative supplying condensed skim or tailored milk must be born by the fluid processor. In its recommendations, the Panel does not consider these costs in the calculation of transportation credit rates (or of transportation allowance rates). Instead, the Panel considers both hauling rates when setting transportation credit rates (and transportation allowance rates) and relative costs to the Pool of the allowance and credit systems.

Additionally, other issues have to be considered in any discussion of transportation credits (and transportation allowances):

- All interested parties must rely on information released by the few organizations involved with milk shipments
- CDFA haul data has lengthy lag time
- Energy costs are in constant flux
- Southern California specific –
  - Dairies leaving Southern California

- Institutional patterns of milk movement
- Local milk used in manufacturing plants that is unavailable for higher usage
- More milk and more distant milk needed
- Trucks bring excess fat and water in the form of ranch milk from the Southern San Joaquin Valley, then haul the fat back in the form of cream after the water is evaporated off

## **Transportation Credits for Northern California**

### **Background**

Currently in Northern California, transportation credits are only established for the Bay Area Receiving Area. The rates are \$0.38/cwt. from Merced and Stanislaus counties and \$0.27/cwt. from Sonoma County. Neither credit has been changed since 1991. The credit from Sonoma County has not been used since 1995. While both Sacramento and North Bay have transportation allowances, there are no transportation credits.

### **Proposals and Analysis**

Crystal proposed that a new credit be established from Merced and Stanislaus counties to Sacramento County. Crystal's testimony suggested a rate of \$0.75/cwt. based on costs ranging from \$0.60 to \$0.80/cwt. The Institute was supportive of the concept of transportation credits for both Sacramento and North Bay. CDI felt the issue needed further review because Crystal made the proposal on the day of the hearing.

### **Discussion**

Because of very recent changes in Crystal's plant operations, they did not see the need for transportation credits to Sacramento until a few days before the hearing. As a result, there was no analysis of this proposal at the prehearing workshop, and most other witnesses had no opportunity to prepare comments on the proposal prior to the hearing. The Institute, however, did make a valid point when it stated:

*"Transportation credits are currently available . . . to plants in Southern California . . . and to plants in the Bay Area. Credits are not available on shipments to plants . . . in the North Bay and Sacramento receiving areas, although there appears to be no valid reason why plants in those areas should not be eligible if their operations utilize plant-to-plant shipments of milk or condensed skim."*

There was no specific testimony on establishing credits for North Bay or changes to credits rates for the Bay Area. In the interests of equal raw product cost, the Panel made a review of credits for plants in all three areas. Generally, it seemed possible to establish credit rates that would be equitable for all three areas. There were, however, two specific points that remained unresolved:

- What should be the basis for the actual level of the credit rates:
  - only plant-to-plant hauling costs, or
  - plant-to-plant hauling costs, but no greater than equivalent rates for transportation allowances.
- In addition to Merced and Stanislaus counties, should Humboldt County and possible other counties be considered as sources of supply.

## **Panel Recommendation:**

The Panel recommends that transportation credits for Sacramento and the North Bay Receiving Areas not be established at this time.

## **Transportation Credits within Southern California**

### **Background**

In the June 2001 decision, a transportation credit was given to plants supplying Orange, Riverside, San Diego and Ventura counties from Los Angeles County. In an attempt to be equitable with credits available to other regions, the credit rate was set to \$0.24/cwt. After the 2001 decision, concerns were raised as to the inequity that could be created as a result of the credit. As the Panel Report of June 4, 2003 stated,

*“There’s one specific concern that the Panel has regarding its proposed credits for condensed skim. It may be possible for a plant to receive an allowance for incoming milk and then a credit for the condensed skim that leaves the plant. The Panel discussed prorating the allowance against the credit. However, it decided to monitor the situation as it unfolds.”*

As it has unfolded, the Department determined at the last Hearing in January of 2006, that the prior decision to allow this transportation credit resulted in an inequity and “double-dipping” from those plants utilizing both transportation allowances and credits to move milk. The Panel addressed this issue in the January 2006 decision by cutting the then credit of \$0.34/cwt. to \$0.26/cwt.

### **Proposals and Analysis**

CDI has proposed to increase the transportation credit rate to \$0.37/cwt., arguing the original credit of \$0.34/cwt. should not have been reduced, and instead, the rate ought to be increased given rising fuel costs. For the time period of May 2005 to April 2006, at the then current rate of \$0.34/cwt., costs to the Pool from transportation credits from Los Angeles to Riverside, Orange, San Diego, and Ventura totaled \$86,323. Assuming the new rate (effective April 2006) of \$0.26/cwt. was in place May 2005 through April 2006, the total cost to the Pool from credits for the same year from Los Angeles to Riverside would have been reduced to \$66,012. At the proposed rate of \$0.37/cwt., costs would have increased to \$93,940.

### **Discussion**

It is the Panel’s intent to facilitate a competitive and efficient market in which all California processors can be competitive. The transportation credit given to milk supplying Riverside from the Los Angeles region gives a competitive advantage to plants utilizing tailored milk over plants utilizing in-plant condensing or purchasing condensed skim. The Panel feels no one plant should be better off than another fluid milk plant solely through the milk movement system. Departmental analysis shows raw product costs for a Southern California Class 1 plant utilizing tailored milk currently has more than a \$.02/gallon advantage over similar plants utilizing in plant condensing or purchasing condensed skim (see Table 8)

**Table 8 - Raw Product Cost per Gallon and per Cwt.  
less Fortification Allowances, Transportation Allowances, and  
Transportation Credits, Using 2%,10% Milk**

Plant type by condensing method	Raw Product Costs less, FA, TA, TC	
	\$/gallon	\$/cwt
In Plant Condenser	\$0.899	\$10.39
Buy Condensed	\$0.898	\$10.38
Buy Tailored	\$0.876	\$10.13

FA, TA, TC are respectively, fortification allowance, transportation allowance and transportation credit

The Panel reiterates the four principle criteria from the January 31, 2006 hearing in consideration of the requested increase in transportation credits from Los Angeles to Orange, Riverside, San Bernardino, San Diego, and Ventura:

1. The cost to the Pool of the transportation credits for shipping tailored milk via plant-to-plant shipments,
2. The cost to the Pool for comparable transportation allowances for ranch-to-plant shipments plus the cost of the transportation credits for milk moved plant-to-plant within Southern California
3. When setting allowances and credits, equity among competing Class 1 plants in attracting milk supplies must be considered
4. Preserving fair competition among competing milk suppliers and not encouraging or promoting monopoly power on supplying producer organizations

The Panel does not wish to promote an extenuation of a policy that violates the above tenets. However, the Panel is mindful of the impact of policy changes, and therefore suggests that a shift in policy can be done more slowly to allow time for a recoup of investments made based on prior policy. The Panel does concede that in the worse case scenario, more would be lost to the Pool if any account were lost to other competitors. In assessing this risk, the Panel notes that California producers now have an improved competitive advantage over other competitors based upon recently enacted federal legislation. That legislation now requires other competitors to pay into the federal Pool, and therefore incurring higher fluid milk prices relative to California.

Lastly, the petitioner offered an analysis of comparable credits and allowances that suggested that the current method actually costs less money to the Pool than otherwise. However, the Panel finds a more comparable analysis must include other plants receiving milk from Kern and Tulare which do not utilize transportation credits. Table 9 shows the petitioners calculations in comparison with plants not utilizing the transportation credit. In addition, the assumption that milk coming from these areas is destined for whole milk (3.5 percent, 8.7 percent milk) is less representative of the actual composition of fluid milk products. More of this milk is actually reduced fat milk (2 percent, 10 percent milk), which effectively means a higher allowance rate. Table 9 calculates the difference in these hauling rates under these differing assumptions of credit usage and milk composition. The analysis shows a clear competitive advantage for any Riverside plant receiving milk via Artesia and using both an allowance and credit versus other Southern California processing facilities not receive a credit.

**Table 9 - Comparison of Costs to the Pool in Terms of Credits and Allowances  
(CDI proposal vs. Current Rates)**

	<b>Kern Ranch to LA (89-139 miles) to So. CA</b>	<b>Tulare Ranch to LA (over 139 miles) to So. CA</b>	<b>Tulare Ranch to Tulare to Riverside or San Diego (over 139 miles)</b>	<b>Kern Ranch to to any So. CA (89-139 miles)</b>	<b>Tulare Ranch to to any So. CA (over 139 miles)</b>
<b>Whole Milk (3.5% 8.7%) in \$/cwt</b>					
Allowance	\$0.55	\$0.74	\$0.00	\$0.55	\$0.74
Credit	\$0.37	\$0.37	\$0.85	\$0.00	\$0.00
Differential	\$0.00	\$0.00	\$0.27	\$0.00	\$0.00
<b>TOTAL</b>	<b>\$0.92</b>	<b>\$1.11</b>	<b>\$1.12</b>	<b>\$0.55</b>	<b>\$0.74</b>
<b>Reduced Fat Milk (2% 10%) in \$/cwt</b>					
Allowance	\$0.63	\$0.85	\$0.00	\$0.63	\$0.85
Credit	\$0.37	\$0.37	\$0.85	\$0.00	\$0.00
Differential	\$0.00	\$0.00	\$0.27	\$0.00	\$0.00
<b>TOTAL</b>	<b>\$1.00</b>	<b>\$1.22</b>	<b>\$1.12</b>	<b>\$0.63</b>	<b>\$0.85</b>
= CDI's Proposed Allowance and Credit Rates					

### **Panel Recommendation:**

- Increase the credit from Los Angeles County to Orange, Riverside, San Bernardino, San Diego, and Ventura counties from \$0.26/cwt. to \$0.30/cwt.

Processors, mainly producer cooperatives, serving the fluid market will receive increased compensation of \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$10,156/month of Class 1 revenues. To fund all transportation credits within Southern California, total compensation will increase 15.39 percent to \$76,167/month of Class 1 revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **Transportation Credits to Southern California**

In determining appropriate levels of the transportation credits other than those from Los Angeles County, the Panel must ensure rates are comparable across locations. Given the Panel recommendation to increase the Los Angeles credits by \$0.04/cwt., the Panel determined credits from the remaining supply areas of Tulare County and Kings and Fresno counties also should be increased by \$0.04/cwt.

### **Panel Recommendation:**

- Increase the credit from Tulare County to Los Angeles, Orange and Ventura counties from \$0.69/cwt. to \$0.73/cwt.
- Increase the credit from Tulare County to Riverside and San Diego counties from \$0.77/cwt. to \$0.81/cwt.
- Increase the credit from Kings and Fresno counties to Los Angeles, Orange and Ventura counties from \$0.72/cwt. to \$0.76/cwt.
- Increase the credit from Kings and Fresno counties to Riverside and San Diego counties from \$0.80/cwt. to \$0.84/cwt.

Processors, mainly producer cooperatives, serving the fluid market will receive increased compensation of \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$1,411/month of Class 1 revenues. To fund all transportation credits to Southern California, total compensation will increase 2.96 percent to \$49,073/month of Class 1 revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

## **Transportation Credits for Condensed Skim**

### **Proposals and Analysis**

WUD, with MPC's support, proposed the elimination of transportation credits for condensed skim. This proposal was opposed by Crystal, Institute, and LOL. At the milk movement hearings held in August 2004 and January 2006, the Department denied similar proposals to eliminate the credits for condensed skim. For the 12 months ending October 2005, elimination the transportation credits for condensed skim would have reduced annual Pool costs about \$225,000.

The Department established credits for condensed skim shipped plant-to-plant on a statewide basis as a result of the milk movement hearing held in June 2003. The establishment of the credit for condensed skim:

1. Gives the Class 1 processors additional options for securing their milk supplies;
2. Facilitates the effective movement of condensed skim used for Class 1 fortification;
3. Assists California's fluid processors in meeting California's fluid milk standards; and
4. Allows California condensed skim to remain a competitive source of solids-not-fat (SNF) for fortification.

As noted in the Hearing Panel Report for the January 31, 2006 hearing:

- Elimination of credits for condensed skim will result in a savings to the Pool of a few pennies for every pound of SNF in the condensed skim.
- Decreased sales of condensed skim will result in a loss to the Pool of over twenty-five cents for every pound of SNF in the condensed skim sales lost.
- California's share of condensed skim arriving at Southern California plants had declined from 91 percent to 84 percent.

Given all of the above, particularly the potential net reduction of Pool revenue due to lost sales of California produced condensed skim, the Panel reiterates its concern about any proposal that would affect the competitiveness of California condensed skim.

### **Panel Recommendation:**

Make no changes to the eligibility of condensed skim for transportation credits.

## DISCUSSION AND RECOMMENDATIONS FOR STUDY ISSUES

### **Fuel Indexing**

Since their inception in the early 1980s, the Department has established transportation allowance and credit rates as fixed values that change through the hearing process.

At the January 2006 hearing, DFA proposed indexing transportation allowance rates based on the price of diesel fuel, specifically, the weekly price for diesel fuel in California as published by the U.S. Department of Energy. While several witnesses supported this concept, many added their concerns. While not proposing fuel indexing at this hearing, DFA did “ask the Department to consider a fuel indexing plan and provide the guidelines and action steps necessary to implement one.” (DFA alternative proposal dated May 23, 2006.)

An indexing proposal using diesel fuel prices had been made at the milk movement hearing held in July 1994; the Department found that “*there may be merit to a formula based on fluctuations in fuel costs. While several witnesses expressed support for such a formula in concept, there was a consensus that further study by the industry was needed prior to its adoption. The Department concurs.*” (Statement of Determination and Order of the Secretary, Hearing held July 19, 1994.) Stakeholders did not pursue fuel indexing after the 1994 hearing, and the issue lay dormant until DFA made its proposal at the January 2006 hearing.

The Panel reiterates its statement in the Panel Report from the January 2006 hearing:

*“While appropriate for hauling contracts that are rebased every year, it appears that DFA’s specific [fuel indexing] proposal may not be a suitable method of indexing transportation allowance rates. Given however that energy prices are increasing at a much faster rate than historically, the concept of fuel indexing should be given future consideration. Prior to . . . consideration, the Panel would like to see further study on how well the projected transportation allowance rates using the proposed index tracks against the actual hauling rates in the various mileage brackets over some time period.”*

### **Using \$/lb-snf for Transportation Allowance and Credits Rates**

For condensed skim the combination of transportation allowances and credits within Southern California far exceeded the transportation credits only from the southern San Joaquin Valley (hearing exhibit 6d, page 9). The problem, however, is not due to the combination of transportation allowances and credits. The transportation allowances alone are the problem. Additionally, there is little economic reason to ship the fluid carrier to Southern California only to discard most of it in making condensed skim, especially when some of the finished cream is hauled back to the southern San Joaquin Valley. Lowering the allowances to address this condensed skim issue would however, result in disruption of milk used for fluid products (whole, 2-10, 1-11, skim).

The Panel Report for the January 2006 hearing identified a possible solution: change the transportation allowance and/or credit rates from dollars per cwt. to dollars per pound of SNF. Most witnesses supported the premise that transportation allowances and credits

should be set at the least cost to move the required milk, but the solution of converting to \$/lb-snf was only briefly addressed in the record of the July 2006 hearing. Converting rates from a \$/cwt. basis to a \$/lb-snf basis could result in unintended consequences that the witnesses were unprepared to address at the July 2006 hearing. The Panel reiterates its belief that prior to making any hearing consideration on this conversion, it would be far better to evaluate thoroughly this approach via public forums or workshops. This would give interested stakeholders a chance to present both reasonable objections and better alternatives.

### **Time Period for Milk Movement Requirements**

The milk movement requirements are in place each year from September to April of the following year. The current milk movement requirements were first made part of the stabilization and marketing plans in 1983. At that time, most schools started their school year at the beginning of September. Now, a quarter of all students attend schools with a year round schedule, and many other schools start their school years in August.

From July 13 to 28, 2006, California experienced a record setting heat wave:

*Table 10 - Record Setting  
Days Above 100 Degrees*

<b>Location</b>	<b>Days Above 100 Degrees</b>
Redding	15
Sacramento	11
Modesto	12
Fresno	14
Bakersfield	15
Ontario	10
Palmdale	14

The impact on July production will not be known until mid-August, and the long-term impact will play out over the next year. It is apparent already, however, that the heat wave resulted in a significant reduction in milk production, at least in the short run.

The changes to California school schedules combined with the July heat wave has made it apparent that there is a need to review the current September to April period for the milk movement requirements.

### **Panel Recommendation:**

Immediately following the announcement of this hearing decision, the Department will:

- Direct Dairy Marketing and Milk Pooling staff to perform, within five months of the determination announcement of this hearing, necessary and appropriate analysis on the fuel index concept.
- Call a public meeting with the Dairy Advisory Committee to review the analysis and data, including development of additional alternatives.

- Develop consensus among all interested parties on the general policy objectives that are being sought with the possible implementation of the alternatives developed.

The Panel also recommends that the industry give consideration to changing the rates from a \$/cwt. basis to a \$/lb-snf basis, and that the industry evaluate the time period requirements for the call provisions.

This Hearing Panel Report has been prepared and submitted by:

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Candace Gates  
Research Manager II  
Dairy Marketing Branch

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John Lee, Chief  
Milk Pooling Branch

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Thomas W. Gossard  
Senior Agricultural Economist  
Dairy Marketing Branch

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Donald Shippelhoute  
Senior Agricultural Economist  
Milk Pooling Branch

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Hayley Boriss  
Agricultural Economist  
Dairy Marketing Branch

## SUMMARY OF PANEL RECOMMENDATIONS

### DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION ALLOWANCES NORTHERN CALIFORNIA

#### Panel Recommendation:

For the Bay Area Receiving Area:

- +\$0.01/cwt. from \$0.26/cwt. to \$0.27/cwt. for 0 to 99
- +\$0.03/cwt. from \$0.31/cwt. to \$0.34/cwt. for over 99 to 199
- +\$0.04/cwt. from \$0.32/cwt. to \$0.36/cwt. for over 199

For the North Bay Receiving Area:

- no change for 0 to 44, will remain at \$0.19
- +\$0.03/cwt. from \$0.26/cwt. to \$0.29/cwt. for over 44 to 99
- +\$0.03/cwt. from \$0.31/cwt. to \$0.34/cwt. for over 99

For the Sacramento Receiving Area:

- +\$0.01/cwt. from \$0.14/cwt. to \$0.15/cwt. for 0 to 59
- +\$0.03/cwt. from \$0.17/cwt. to \$0.20/cwt. for over 59

Most producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$24,079/month of Pool revenues. To fund all transportation allowances in Northern California, total compensation will increase 6.14 percent to \$415,946/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION ALLOWANCES FOR SOUTHERN CALIFORNIA

#### Mileage Brackets and Eligible Counties

#### Panel Recommendation:

- Establish separate rates and brackets for milk coming from Los Angeles, Riverside and San Bernardino counties compared to the other 55 counties in California.
- Adopt a 109-mile cutoff between the second and third mileage brackets for the other 55 counties.
- Eliminate the last two mileage brackets for Los Angeles, Riverside and San Bernardino counties.

#### Rates for Southern California

#### Panel Recommendation:

- Change the over 89 to 122 mileage bracket to over 89 to 109 miles
- Change the over 122 to 139 mileage bracket to over 109 to 139 miles
- Change the following rates for the Southern California Receiving Area, from all counties other than Los Angeles, Riverside and San Bernardino counties:
  1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt. for 0 to 89 miles
  2. +\$0.17/cwt. from \$0.20/cwt. to \$0.37/cwt. for over 89 to 109 miles
  3. +\$0.04/cwt. from \$0.52/cwt. to \$0.56/cwt. for over 109 to 139 miles
  4. +\$0.05/cwt. from \$0.65/cwt. to \$0.70/cwt. for over 139 miles

Producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.17/cwt. This increased compensation will be funded by redistributing an additional \$150,795/month of Pool revenues. To fund this portion of transportation allowances in the Southern California Receiving Area, total compensation will increase 10.88 percent to \$1.54 million/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **Barstow Area Milk**

#### **Panel Recommendation:**

Establish Los Angeles, Riverside, and San Bernardino counties as Supply Counties to the Southern California Receiving Area with the following rates:

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt., for 0 to 89 miles
2. No change, remain at \$0.20/cwt., for over 89 miles

Producers serving the fluid market in the 0 to 89 miles bracket will receive increased compensation of \$0.01/cwt. Producers beyond 109 miles bracket will receive decreased compensation of \$0.32/cwt. to \$0.45/cwt. This change in compensation will result in a net reduction in redistribution of Pool revenues of \$19,738/month. To fund this portion of transportation allowances in the Southern California Receiving Area, total compensation will decrease 13.71 percent to \$124,183/month of Pool revenues. (This estimated funding decrease assumes that these rates had been in place during the 12 months ending April 2006).

#### **Net Effect of Recommendations for the Southern California Receiving Area**

Most producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.17/cwt., while some producers in the Bartow area will receive decreased compensation of \$0.32/cwt. to \$0.45/cwt. This net increase in compensation will be funded by redistributing an additional \$131,056/month of Pool revenues. To fund all transportation allowances in the Southern California Receiving Area, total compensation will increase 8.57 percent to \$1.66 million/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **San Diego Receiving Area**

#### **Panel Recommendation:**

1. +\$0.01/cwt. from \$0.10/cwt. to \$0.11/cwt. for 0 to 89 miles
2. No change in the \$0.43/cwt. rate for over 89 to 139 miles
3. +\$0.05/cwt. from \$0.65/cwt. to \$0.70/cwt. for over 139 miles

Many producers serving the fluid market will receive increased compensation of \$0.01/cwt. to \$0.05/cwt. This increased compensation will be funded by redistributing an additional \$600/month of Pool revenues. To fund transportation allowances in the San Diego Receiving Area, total compensation will increase 8.36 percent to \$7,785/month of Pool revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

## **DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION CREDITS FOR FLUID MILK AND CONDENSED SKIM**

### **Transportation Credits for Northern California**

#### **Panel Recommendation:**

The Panel recommends that transportation credits for Sacramento and the North Bay Receiving Areas not be established at this time.

### **Transportation Credits within Southern California**

#### **Panel Recommendation:**

- Increase the credit from Los Angeles County to Orange, Riverside, San Bernardino, San Diego, and Ventura counties from \$0.26/cwt. to \$0.30/cwt.

Processors, mainly producer cooperatives, serving the fluid market will receive increased compensation of \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$10,156/month of Class 1 revenues. To fund all transportation credits **within** Southern California, total compensation will increase 15.39 percent to \$76,167/month of Class 1 revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **Transportation Credits to Southern California**

#### **Panel Recommendation:**

- Increase the credit from Tulare County to Los Angeles, Orange and Ventura counties from \$0.69/cwt. to \$0.73/cwt.
- Increase the credit from Tulare County to Riverside and San Diego counties from \$0.77/cwt. to \$0.81/cwt.
- Increase the credit from Kings and Fresno counties to Los Angeles, Orange and Ventura counties from \$0.72/cwt. to \$0.76/cwt.
- Increase the credit from Kings and Fresno counties to Riverside and San Diego counties from \$0.80/cwt. to \$0.84/cwt.

Processors, mainly producer cooperatives, serving the fluid market will receive increased compensation of \$0.04/cwt. This increased compensation will be funded by redistributing an additional \$1,411/month of Class 1 revenues. To fund all transportation credits to Southern California, total compensation will increase 2.96 percent to \$49,073/month of Class 1 revenues. (This estimated funding increase assumes that these rates had been in place during the 12 months ending April 2006).

### **Transportation Credits for Condensed Skim**

#### **Panel Recommendation:**

Make no changes to the eligibility of condensed skim for transportation credits.

### **Discussion and Recommendations for Study Issues**

#### **Panel Recommendation:**

Immediately following the announcement of this hearing decision, the Department will:

- Direct Dairy Marketing and Milk Pooling staff to perform, within five months of the determination announcement of this hearing, necessary and appropriate analysis on the fuel index concept.
- Call a public meeting with the Dairy Advisory Committee to review the analysis and data, including development of additional alternatives.
- Develop consensus among all interested parties on the general policy objectives that are being sought with the possible implementation of the alternatives developed.

The Panel also recommends that the industry give consideration to changing the rates from a \$/cwt. basis to a \$/lb-snf basis, and that the industry evaluate the time period requirements for the call provisions.

## *ATTACHMENT A-2*

### *Summary of Testimony, Submitted Briefs and Letters, and Post Hearing Briefs*

#### **CALIFORNIA DAIRIES INC. – Gary Korsmeier**

- The results from the January 31, 2006 hearing will result in more distant milk movement to the Southern California Class 1 market at a significant additional cost to the overall producer Pool
- Escalating diesel fuel costs as well as increased costs in wages, insurance and employee benefits, have cause transportation costs to continue to increase since the last hearing
- CDI remains consistent in their objective that producers should be responsible for local hauls and transportation allowances and credits should compensate those producers or plants that service the needed Class 1 market from outside local areas. And incentives should be from the closest available production area thereby discouraging milk movement from distant locations and minimizing the cost to the Pool
- CDI carries the largest responsibility to supply and balance the Southern California Class 1 market
- Changes that have occurred in the mileage brackets encourage CDI to deviate from their current practice of prioritizing more local milk for Class 1 markets as the milk currently located in San Diego County will have an incentive to move to a Riverside County instead of Los Angeles. Without the proposed changes CDI will eventually be required to haul more milk out of Tulare County at a higher transportation allowance to move milk to Los Angeles. A similar situation is likely to arise for milk in the San Bernardino County which has been used to satisfy the Class 1 market in Los Angeles.
- The most recent expansion in one of the mileage brackets to 122 miles places a disadvantage to CDI milk coming out of Kern County and creates incentive for CDI to divert this milk to Tulare via a backhaul and move Tulare County milk to Los Angeles, thus increasing the cost to the Pool
- CDI expended \$500,000 in processing equipment to facilitate a fluid processor's requirements so as to keep the processor from seeking to source an out-of-state supply
- The recommended changes to transportation credits are cost justified and support CDI's past positions of a slight disincentive from Tulare County and higher disincentive from Fresno and Kings Counties to Los Angeles

#### **DRIFTWOOD DAIRY – James Dolan**

- Studies have shown that plant-to-plant movement of milk from South Valley to Southern California is just as efficient if not more so, than ranch-to-plant from the Valley to Southern California, allowing movement of milk components without having to haul unwanted fat

- For Driftwood to continue to be a competitive and viable member of the Southern California supply chain, they must be able to move milk in Tulare to Southern California at no disincentive.
- The current shortfall after the last hearing is \$.1925 cent per cwt. An increase in the credits from \$.69 to \$.9075 cwt. would effectively leave Driftwood expense neutral
- Eliminating disincentives to move Valley to Southern California will help insure an adequate and timely supply of milk for Southern California and will allow equal raw product costs under equal terms for that milk

#### **WESTERN UNITED DAIRYMEN – Tiffany LaMendola**

- Transportation allowances are paid to producers (not plants) and allowances on ranch-to-plant shipments constitute 94percent of the cost to the Pool from the transportation system
- Transportation incentive program costs have increase with more milk being shipped greater distances to supply the Southern California fluid milk market. But at the same time a great deal of the declining local Southern California milk supply is being used for non-fluid purposes such as cheese
- Data indicates that now nearly all of the condensed skim demanded from Southern California is now supplied from within that region even in light of the fact that condensed skim credit was available for shipments from the South San Joaquin Valley
- WUD's proposal does not change the current supply situation of ranch milk being moved to Southern California and then subsequently manufactured into condensed skim
- Producers are already funding the transportation of ranch milk to Southern California and thus should not also be required to fund the transportation of a manufactured product plant-to-plant in Southern California.
- Some milk receives a transportation allowance and then a transportation credit on condensed skim supplied from Los Angeles, which goes beyond the original intent of the incentive system and increases costs to the Pool
- The elimination of credits for condensed skim may have been less disruptive than the Panel's prior decision to reduce the transportation credit for milk and condensed skim within Southern California.
- Producers already fund a fortification allowance on condensed skim used for fortification purposes
- It appears that out-of-state sourced condensed skim has increased, leaving questions as to the efficacy of providing credits on condensed skim to capture those sales for California suppliers and whether there exist competitive situations in place that supersede the benefit of credits for California condensed skim

- WUD supports the transportation allowance bracket and rate adjustments requested by CDI. The changes appear to be cost justified, aim to encourage milk to move to the Class 1 markets rather than local manufacturing plants and aim to prevent overcompensation for hauling costs through transportation allowances with respect to San Bernardino County
- Western United also supports CDI's proposal for the furthest out brackets in San Diego receiving area as there is no reason for larger rates for further out brackets if the milk from those areas is not needed to sufficiently supply the one processing plant located in San Diego County. If future conditions warrant a change, then a change can be made at that time
- WUD can not support another rate increase at this time above those contained in CDI's original petition. It is apparent that current diesel prices are similar (At least within a range) to those in August 2005
- In the past, WUD has supported cost-justified increases to transportation credits in so much that the resulting credits did not cost the Pool more money than moving the equivalent amount of milk via transportation allowances. Given the current rates and differentials it is still more cost effective to move milk via allowances rather than credits. This may not be the case if the receiving plant in Southern California can only accept standardized milk and hence ranch-to-plant milk may not be an option
- Any further loss in Class 1 sales to out-of-state suppliers should be avoided
- WUD does not support Driftwood Dairy's alternative proposal as the proposed increase does not appear to be cost justified and greatly exceeds the level recently established by the Department
- WUD does not support Security's alternative proposal as it goes against the basic principle of encouraging the closest milk to move first
- WUD does not support DFA's alternative proposal

#### **SECURITY MILK PRODUCERS ASSOCIATION – Hank Perkins**

- Proposal deals solely with Transportation Allowances into the Southern California receiving area
- Fuel prices continue to rise and the haul rate from Tulare to Los Angeles has risen by \$.09 per hundredweight solely because of fuel surcharges
- As of June 23, 2006 the effective haul rate was \$1.15/cwt. Subtracting a local haul rate of \$.30 and proposed Allowance of \$.80 leaves a \$.05 shortfall as is customary with the northern most milk
- For Kern County into Los Angeles, the total haul is \$.87. Subtracting the local haul leaves \$.57 which is the proposed allowance for the bracket 109-139 miles

- No objections to CDI's proposal to change the mileage brackets for the Southern California receiving area
- Interested in the concept of a fuel adjuster in the Transportation Allowance system

#### **DAIRY FARMERS OF AMERICA – Gary Stueve**

- Testimony deals primarily with necessary adjustments to Transportation Allowances due to changes in diesel fuel prices and a broad general freight rate increases
- The mileage brackets established as a result of the last hearing have created a problem in the South Valley whereby at least one DFA producer now only qualifies for a \$.20 Allowance while the actual costs is the same as the other producers in the area, thereby creating a disincentive to supply the Class 1 markets
- DFA's proposal is to reconfigure the mileage brackets to better reflect the differentiation in hauling costs in the South Valley while still allowing the High Desert area to be fairly represented
- Intended to include San Bernardino County in the Southern California receiving area which was inadvertently left out of the original proposal

#### **DAIRY INSTITUTE OF CALIFORNIA – William Schiek**

- The application of the shortfall concept should be limited to the most distant milk supplies only
- Milk should be attracted to Class 1 plants at order prices. Existing order prices paid by processors provide more than enough revenue to attract milk for Class 1 and mandatory Class 2 purposes. Processors should not need to subsidize the haul to their plants with over-order premiums given the relatively high Class 1 price differential relative to the low utilization
- It is incorrect to view the sole purpose of the Class 1 price differential as a means of enhancing producer income, as it was designed in part to assure Class 1 markets are served
- Any changes to allowance and credit rates should be based on the most recent rate and fuel cost information available to the Panel. The Institute supports cost-justified adjustments but has no access to broad data that are reflective of current milk movement costs across the state and instead rely on other testimony presented
- Allowances and credits must be adequate to encourage milk to move to higher-use plants in deficit areas
- Allowances should be equal to the difference between the cost of the local haul and the cost of the haul to higher-use metropolitan plants with a slight shortfall applied only to the most distant mileage brackets to encourage closer milk to move first

- There should be no shortfall in allowances on milk coming from as far away as Tulare and Kings County to serve Southern California because of the increasing volumes of milk that are necessary to supply the region
- Similarly there should be full compensation through credits for all but the most distant milk to encourage competition in supplying the Class 1 market, which is especially important for milk coming from the South Valley into Southern California
- Equity among Class 1 plants competing for milk supplies needs to be considered. Credits are currently available on shipments of milk and condensed skim to plants in Southern California and the Bay area, but are not available to plants in the North Bay and Sacramento regions, although there appears to be no valid reason why they shouldn't be eligible
- The Department should be cognizant of the impact of its past policies on plant investment decisions when setting a future direction for milk movement incentives
- CDI's proposals appear to be cost justified, but Institute believes there should be no shortfall in allowance rates to Southern California except for milk originating beyond Kings and Tulare. Shortfalls on plant-to-plant shipments into Los Angeles and Riverside should also be eliminated
- To the extent that "closer in" milk has been made less likely to be attracted to Class 1 uses than more distant milk, the situation should be corrected
- Institute supports DFA's proposed allowances in the Bay Area, Sacramento and North Bay receiving areas and believes DFA's previous indexing concept merits further study. The Institute would like to see how well the index tracks with actual hauling rates
- Security's proposed allowance rate for the "over 139 miles" over-compensates producers for the difference between the local haul cost and the Southern California haul cost
- Institute does not support Western United's proposal to eliminate credits for condensed skim as it seems possible maintaining credits for condensed skim could reduce the future costs to the Pool with more milk being drawn from the South Valley to meet Southern California's needs
- Institute supports the continuation of the call provisions

#### **MILK PRODUCERS COUNCIL – William C. Van Dam**

- MPC concludes that is not appropriate to emphasize the delivery of "close in" milk to Class 1 plants in the Southern California region in order to set up a workable, long-term solution for the future
- Users of products must pay the cost of getting product to their location (when the supplier has an alternative local market). MPC suggests sellers of bulk milk consider surcharges on deliveries of milk to plants as unavoidable costs should be passed on

- MPC does not support indexing to the formulas
- MPC does not object to adjustments based on real increases in costs but urge the Department to carefully verify any adjustments made as MPC is not privy to the details of milk shipments
- If this “quick call” is because of and “unintended consequence” of the previous hearing, MPC supports a quick finding designed to correct those specific issues
- Support WUD in that transportation credits should not be applied to condensed skim. Getting credits and fortification allowances on the same condensed is a form of double dipping that should not be allowed

#### **LAND O’ LAKES – James W. Gruebele**

- Supports cost-justified changes in credits on milk moving from the South Valley into Southern California as proposed by Driftwood. Based upon the changes in freight rates, the Driftwood proposal makes sense
- Support the inclusion of condensed skim as it encourages the movement of milk components in an efficient, cost effective manner. Nothing has changed since the last hearing and the Panel’s findings, and the Department analysis shows using condensed skim from Tulare to Southern California was more efficient than supplying those solids on a ranch-to-plant basis
- To facilitate producer equity to all supply areas in Southern California, after applying the transportation allowance, producers in the high desert should be responsible to pay the equivalent of a local haul. If that is not the case, the allowance in the high desert should be changed
- Support CDI’s proposal to adjust allowances for milk from Santa Barbara, San Diego, Imperial, Kern, Tulare, Kings and Fresno to Southern California for the bracket “over 109-139 miles” as freight costs have increased by 6.5 cents per cwt.

#### **CRYSTAL CREAMERY – Sharon Hale**

- The company that hauls Crystal’s producer’s milk increased the base haul rate by \$.06 per hundredweight effective July 1, 2006 with an additional increase of \$.04 per hundredweight due August 1, 2006
- Last Friday the company announced it is planning to close the downtown facility which will impact their ability to produce their own condensed skim for fortification
- Given the recent experience of large Crystal producers moving to a new buyer despite an abundance of milk suggests milk movement incentives into Sacramento are still required
- Crystal requests to expand transportation credits to include Sacramento County. With the changes that have occurred within Crystal over the past few years, the inclusion of Sacramento into the transportation credit system is now warranted as solids for fluid

fortification will have to come from manufacturing plants out of the area by the end of summer

- Stanislaus and Merced county plants would be the most likely source for plant-to-plant shipments, but Fresno or even Tulare are options as well. The closest plant in Stanislaus is 70 (physical) miles away suggesting the haul cost just under \$.60 per cwt. in August of 2005 and \$.80 for the furthest location. It would be appropriate to use \$.75 per cwt. as a starting point
- Crystal opposes the removal of condensed skim from the list of eligible products for credits. Tailored milk is eligible for transportation credits and without the inclusion of condensed skim in the credit system the economic advantage would lean toward the tailored milk supplier with the fluid processor who prefers to purchase condensed skim could be at a competitive disadvantage

### **SWISS DAIRY/DEAN FOODS COMPANY, INC.**

- Support the testimony of Dairy Institute and the request of CDI with respect to changes in credit rates on plant-to-plant shipments from Los Angeles to Riverside
- Transportation allowance and credit rates in place at the time CDI agreed to serve the needs of Swiss created an incentive to make an investment in Artesia rather than Tipton. Creating incentives and then taking them away is destructive to the industry and the competitiveness of California-based plants
- Rapid policy changes can have the impact of “stranding” assets, resulting in economic waste
- When credit rates are not adequate, suppliers have reduced incentive to supply Class 1 markets without a premium from the processor, making the processor less competitive in the marketplace
- The latest hearing decision “singled me out” and put me at a competitive disadvantage among other southern California processors and with respect to out-of-state competition. Swiss was the only entity to have its competitive position worsened as a result of the last hearing even though there was no proposal for such a change and little testimony to that effect
- The California Pool is unable to incentivize ample milk for the Swiss plant and if premiums are the only option of a milk supply, Swiss will have to make difficult decisions in regards to where to source producer milk. Swiss prefers to buy California milk, but buying competitively takes precedence

### **SUMMARY OF POST-HEARING BRIEFS**

#### **CALIFORNIA DAIRIES INC – Gary Korsmeier**

- Without the requested changes there will be market disruption and additional cost to the producer Pool

- San Bernardino and Riverside Counties need to be separated, and once separated, Los Angeles County needs to be added to receive transportation allowances to plants located in the Southern California receiving area
- The most recent comparison by CDFA using Kern County should be used in deliberation as it is more representative of the majority of CDI milk moving from South Valley to Southern California
- Crystal's testimony to add Sacramento County as a deficit County able to receive subsidies is of concern because it was only raised at the hearing. Competitive factors need further review by the processors in surrounding areas
- Request a finding sooner than the 62 days allowed for a decision

#### **DAIRY INSTITUTE – William Schiek**

- In response to the Panel's question on how maintaining competitive parity among processors should be weighed against the Pool cost to producers suggests that two considerations justify some deviation from a rigorous application of milk movement efficiency
  1. Adequate numbers of suppliers serving the Class 1 market so that the market remains competitive and also allows prices to consumers to be fair and reasonable
  2. Competitiveness of fully regulated California fluid processors should be considered as Pool revenues are diminished when out-of-state processors are able to take sales away from California processors
- Although there is concern that transportation credits might exceed allowances, some plants are not able to take all the milk they need in ranch-to-plant form
- There is a strong likelihood that losses of Class 1 sales from plants not able to take ranch-to-plant milk would be acquired by out-of-state processors rather than by California plants and these losses would likely be larger than the costs of "fully compensating" transportation credits

#### **SWISS DAIRY – Steve James**

- Swiss has a very streamlined operation and lacks the ability to separate and standardize so they cannot rely on ranch-to-plant milk as a sole supply
- Without an adjustment Swiss will lose sales, and more likely these sales will be lost to out-of-state-competitors rather than other California processors
- A possible small degree of inefficiency should be allowed to exist to keep Class 1 sales in California
- Structural changes to the credit system that negatively impact only one producer makes rational business planning impossible